

Rating Action: Moody's reviews NORD/LB's and Deutsche Hypo's Covered Bonds, direction uncertain

19 Dec 2018

Frankfurt am Main, December 19, 2018 -- Moody's Investors Service ("Moody's") has taken the following rating action on Covered Bonds issued by Norddeutsche Landesbank GZ ("NORD/LB"; deposits Baa2 on review direction uncertain; adjusted baseline credit assessment ba3 on review direction uncertain; counterparty risk assessment Baa2(cr) on review direction uncertain) and Covered Bonds issued by Deutsche Hypothekenbank (Actien-Gesellschaft) ("Deutsche Hypo", deposits Baa2 on review direction uncertain; adjusted baseline credit assessment ba3 on review direction uncertain; counterparty risk assessment Baa2(cr) on review direction uncertain):

- Norddeutsche Landesbank GZ - Mortgage Covered Bonds: Aa1 placed on review direction uncertain from Aa1,
- Norddeutsche Landesbank GZ - Public-Sector Covered Bonds: Aa1 placed on review direction uncertain from Aa1,
- Norddeutsche Landesbank GZ - Aircraft Mortgage Covered Bonds: A3 placed on review direction uncertain from A3,
- Deutsche Hypothekenbank (Actien-Gesellschaft) - Mortgage Covered Bonds: Aa1 placed on review direction uncertain from Aa1, and
- Deutsche Hypothekenbank (Actien-Gesellschaft) - Public-Sector Covered Bonds: Aa2 placed on review direction uncertain from Aa2.

RATINGS RATIONALE

Today's rating action is prompted by the review of the ratings assigned to NORD/LB and Deutsche Hypo. For further details, please see "Moody's places long-term ratings of NORD/LB on review with direction uncertain", published on December 18, 2018 at https://www.moody's.com/research/--PR_392759.

The Covered Bonds have been placed on review with direction uncertain because NORD/LB's and Deutsche Hypo's counterparty risk ("CR") assessment has been placed on review with direction uncertain. During the review, Moody's will consider the level of over-collateralisation ("OC"), including OC in "committed" form, that is expected for each programme.

Moody's notes that today's rating action has not been prompted by a deterioration in the credit quality of the cover pool assets backing the issuer's Covered Bonds.

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines Covered Bond ratings using a two-step process: an expected loss analysis and a timely payment indicator ("TPI") framework analysis.

EXPECTED LOSS:

Moody's uses its Covered Bond Model ("COBOL") to determine a rating based on the expected loss of the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the Covered Bonds (a CB anchor event); and (2) the stressed losses of the cover pool assets following a CB anchor event.

The CB anchor for all programmes is CR assessment plus one notch. The CR assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including Covered Bonds. Moody's may use a CB anchor of CR assessment plus one notch in the European Union or otherwise where an operational resolution regime is particularly likely to ensure continuity of Covered Bond payments.

---Norddeutsche Landesbank GZ -- Mortgage Covered Bonds---

The cover pool losses for this programme are 22.5%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 13.3% and collateral risk of 9.2%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 13.8%.

The over-collateralisation in the cover pool is 45.7%, of which the issuer provides 2.0% on a "committed" basis. Under Moody's COBOL Model, the minimum OC consistent with the Aa1 rating is 19.5%, of which 0% needs to be in "committed" form to be given full value. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on the Performance Overview report based on data as per 30 September 2018.

---Norddeutsche Landesbank GZ -- Public-Sector Covered Bonds---

The cover pool losses for this programme are 9.0%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 6.5% and collateral risk of 2.4%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 4.8%.

The over-collateralisation in the cover pool is 11.3%, of which the issuer provides 2.0% on a "committed" basis. Under Moody's Cobol model, the minimum OC consistent with the Aa1 rating is 4.5%, of which 0% needs to be in "committed" form to be given full value. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on the Performance Overview report based on data as per 30 September 2018.

---Norddeutsche Landesbank GZ - Aircraft Mortgage Covered Bonds---

The cover pool losses for this programme are 72.1%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 5.1% and collateral risk of 67.0%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 100%.

The over-collateralisation in the cover pool is 169.4%, of which the issuer provides 2.0% on a "committed" basis. Under Moody's COBOL Model, the minimum OC consistent with the A3 rating is 0%, of which 0% needs to be in "committed" form to be given full value. These numbers show that Moody's is not relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on the Performance Overview report based on data as per 30 September 2018.

---Deutsche Hypothekbank (Actien-Gesellschaft) - Mortgage Covered Bonds---

The cover pool losses for this programme are 14.5%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 8.7% and collateral risk of 5.8%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 8.7%.

The over-collateralisation in the cover pool is 18.8%, of which the issuer provides 2.0% on a "committed" basis. Under Moody's COBOL Model, the minimum OC consistent with the Aa1 rating is 13.0%, of which 0%

needs to be in "committed" form to be given full value. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on the Performance Overview report based on data as per 30 June 2018.

---Deutsche Hypothekenbank (Actien-Gesellschaft) - Public-Sector Covered Bonds---

The cover pool losses for this programme are 12.2%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 8.8% and collateral risk of 3.5%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 6.9%.

The over-collateralisation in the cover pool is 7.5%, of which the issuer provides 2.0% on a "committed" basis. Under Moody's COBOL Model, the minimum OC consistent with the Aa2 rating is 2.5%, of which 0% needs to be in "committed" form to be given full value. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on the Performance Overview report based on data as per 30 June 2018.

For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across Covered Bond programmes rated by Moody's please refer to 'Moody's Global Covered Bonds Monitoring Overview' and 'Global Covered Bonds Sector Update', published quarterly.

TPI FRAMEWORK:

Moody's assigns a TPI, which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the Covered Bond rating to a certain number of notches above the CB anchor.

For NORD/LB's aircraft mortgage Covered Bonds, Moody's has assigned a TPI of "Improbable". The mortgage and public-sector Covered Bonds of NORD/LB and Deutsche Hypo have a TPI of "High".

Factors that would lead to an upgrade or downgrade of the ratings:

The CB anchor is the main determinant of a Covered Bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the Covered Bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the Covered Bonds because of TPI framework constraints.

Based on the current TPI of "Improbable", the TPI Leeway for NORD/LB's aircraft mortgage Covered Bonds is 2 - 3 notches. This implies that Moody's might downgrade the Covered Bonds because of a TPI cap if it lowers the CB anchor by three notches, all other variables being equal.

Based on the current TPI of "High", the TPI Leeway for NORD/LB's mortgage and public-sector Covered Bonds is one notch. This implies that Moody's might downgrade the Covered Bonds because of a TPI cap if it lowers the CB anchor by two notches, all other variables being equal.

Based on the current TPI of "High", the TPI Leeway for Deutsche Hypo's mortgage Covered Bonds is one notch. This implies that Moody's might downgrade the Covered Bonds because of a TPI cap if it lowers the CB anchor by two notches, all other variables being equal.

Based on the current TPI of "High", the TPI Leeway for Deutsche Hypo's public-sector Covered Bonds is two notches. This implies that Moody's might downgrade the Covered Bonds because of a TPI cap if it lowers the CB anchor by three notches, all other variables being equal.

A multiple-notch downgrade of the Covered Bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a Covered Bond rating or negatively affecting the CB Anchor and the TPI; (2) a multiple-notch downgrade of the CB Anchor; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in these ratings was 'Moody's Approach to Rating Covered Bonds' published in November 2018. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

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